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Summary

The State continues to experience problems in accounting and administrative practices that affect the State's internal control system and that result in noncompliance with some state and federal regulations. Internal control problems include overlooked opportunities to increase revenue, failure to cut costs, inappropriate use of public funds, failure to address operational inefficiencies, and inaccurate reporting of financial information. Other weaknesses result in noncompliance with federal program requirements. Although these weaknesses are not individually significant, they have a cumulative effect on the accuracy of reported financial information and on the efficiency, effectiveness, and propriety of the State's operations.

Internal Control Issues

Inadequacies in various state departments' internal controls resulted in lost revenues, unnecessary expenditures, inappropriate use of public funds, operational inefficiency, inaccurate financial information, and other miscellaneous problems. Following are issues of special concern:

Overlooked Opportunities To Increase Revenue

Several state departments overlooked opportunities to increase revenue. The Department of Education submitted late reports required for federal reimbursement resulting in \$190,000 in potential lost interest earnings. Two departments failed to collect reimbursements and fees in a timely manner and deposit them in interest-bearing accounts. One of these departments, the Department of Consumer Affairs (DCA), did not promptly deposit fees collected by its Board of Pharmacy. If the DCA similarly fails to promptly deposit fees for all of its numerous boards and bureaus, it could potentially lose interest earnings of up to \$200,000. In addition, another department, the Council for Private Postsecondary and Vocational Education, incorrectly computed client fees, resulting in an estimated \$132,000 in underpayments.

Cost Savings To Be Achieved

The Department of Health Services took from 12 to 31 months before it began procedures to recover \$2.5 million in overpayments to drug providers for the Medical Assistance Program.

Inappropriate Use of Public Funds

The California Department of Transportation paid its own employees \$4,800 to provide training on behalf of the department. The department contracted with the Regents of the University of California who, in turn, hired the department's own employees to provide part of that training. The department paid these employees \$2,014 more than they would have received for their normal work and paid the university an additional administrative fee, totaling \$480.

Failure To Address Operational Inefficiencies

The Department of Real Estate incurs administrative expenses on collection activities that are unlikely to result in the collection of amounts owed for court judgments against real estate licensees. The department's accounting staff prepare and mail collection letters as required by state administrative practices and as is reasonable in most circumstances. While other collection efforts have yielded less than a 1 percent collection rate, the department has received no benefit from the collection letters.

Inaccurate Reporting of Financial Information

For fiscal year 1995-96, due to inaccurate accounting methods, the Department of Health Services overstated its receivable and liability accounts for the Health Care Deposit Fund and Federal Trust Fund by \$1.3 billion and its revenues and expenditures for the Federal Trust Fund by the same amount.

Additional Control Weaknesses

The Department of Housing and Community Development did not ensure that participants in the Mobilehome Park Resident Ownership Program met program eligibility requirements. Specifically, it approved loans exceeding specific program limitations, inappropriately allowed extended grace periods before payments began, and failed to maintain adequate documentation in a loan file to demonstrate that the borrower met eligibility requirements.

Issues of General Concern Related to Compliance With Federal Requirements

Weaknesses exist in the State's system of controls over cash management, cost allocation, financial reporting, and subrecipient monitoring related to federal grant programs administered by many departments. We noted the following specific conditions:

Cash Management

The State did not always comply with federal regulations for the Cash Management Improvement Act. As a result, for certain federal programs governed by default procedures, the State overstated the interest it owed to the federal government by approximately \$148,200. In addition, for other programs, the State did not consistently limit its requests for cash advances from the federal government. For example, the Department of Health Services maintained excess cash balances between \$1,300 and \$6.3 million for periods ranging from 9 to 18 months.

Cost Allocation

The State improperly allocated personal service costs for some of the federal programs it administers. For example, the Department of Community Services and Development charged three employees' time, totaling 3,071 hours, to the Low-Income Home Energy Assistance Program (LIHEAP) even though the employees worked on a different project to determine eligibility for a state energy assistance program.

The State does not always comply with the requirement to certify or document personal service costs charged to federal programs. Specifically, three departments failed to prepare required periodic certifications when employees worked on a single federal program. In addition, another department failed to maintain certified time sheets for employees working on multiple federal programs to support costs charged to each program.

Financial Reporting

The State does not always ensure that its federal financial reports are accurate and reconcile to the appropriate accounting records. Four departments did not reconcile federal financial reports with appropriate accounting records. Differences ranged from \$104,000 in the Vocational Education Program at the California Community Colleges, Chancellor's Office, to \$23 million for the Refugee and Entrant Assistance—State Administered Program grant at the Department of Health Services. In addition, the Department of Social Services did not have a system of reconciliation in place for reports for several federal grants.

Subrecipient Monitoring

The State does not adequately review audit reports submitted by subrecipients of federal grant moneys. These subrecipients include cities, counties, school districts, and nonprofit organizations. The State also does not ensure that subrecipients promptly correct instances of noncompliance with federal regulations identified in these reports.

Issues Related to Specific Grants

We also found weaknesses in several state departments relating to the administration of individual federal programs under the following federal departments:

U.S. Department of Housing and Urban Development

The State's Department of Housing and Community Development has weak controls over Home Investment Partnerships Program funds. Specifically, the department exceeded administrative and planning costs for this program by \$580,000, did not properly allocate program income at year-end, and incorrectly recorded \$57,000 in administrative charges as program costs. In addition, it reported erroneous and incomplete statistical and fiscal information for two grants to the federal government.

U.S. Department of Education

The State's Department of Education may have inappropriately used federal funds for the Grants to States for the Education of Children With Disabilities program. Specifically, it used these funds to pay \$734,000 in plaintiff attorney fees. Although the Department of Education contends that its use of federal funds for this purpose is allowable, we believe the law does not provide authority for the State to use federal funds to pay these costs. In addition, the Department of Education did not allocate \$76,000 in excess funds for the Emergency Immigrant Education grant among all local educational agencies, as required by federal regulations. Further, it used approximately \$73,000 to fund supplemental programs at five educational agencies.

Federal Emergency Management Agency

The State's Office of Emergency Services used federal funds from the Disaster Assistance Program to fund a project that did not meet the basic eligibility requirements. Specifically, it reimbursed the Los Angeles County Fire Department \$386,000 for costs inconsistent with the State Hazard Mitigation Plan.

U.S. Department of Health and Human Services

The State's Department of Community Services and Development exceeded the amount allowed for planning and administrative costs for the Low-Income Home Energy Assistance Program by approximately \$626,000. In addition, the State's Department of Health Services could not demonstrate that it used 15 percent of HIV Care Formula Grants funds to provide health and support services to specified populations, as required. Finally, during its administration of the Medical Assistance Program, the Department of Health Services had not fully implemented procedures to track and promptly bill drug companies for rebates due the State and the federal government.

Introduction

As part of our examination of the general purpose financial statements of the State of California for the fiscal year ended June 30, 1996, we evaluated the State's internal controls. This evaluation was necessary for the following three reasons:

- To express an opinion on the State's general purpose financial statements;
- To determine compliance with federal grant requirements, laws, and regulations that affect the general purpose financial statements; and
- To determine compliance with state laws and regulations that affect the general purpose financial statements.

During our audit, we reviewed fiscal controls at various state agencies included in the general purpose financial statements. We also selected items from numerous departments for centralized testing of important transaction cycles. For example, we selected and tested a sample of payroll warrants the State processed through its payroll system and a sample of other warrants the State processed through its claims payments system.

We reviewed the compliance of these agencies with state laws and regulations that materially affect the State's financial statements. These laws and regulations help to ensure that the State maintains sufficient control over the budgeting, investing, collecting, and disbursing of state money and accurately reports the results of its financial activities.

Finally, we reviewed the State's compliance with federal regulations for all federal grants exceeding \$20 million. Of the 337 federal grants the State administers, we reviewed 55, which represent approximately 97 percent of the federal funds the State received in fiscal year 1995-96. We excluded federal grants administered by the California State University and the University of California because other independent auditors review them.

The specific scope of our audit is stated in the following reports that the federal Office of Management and Budget, Circular A-128, requires the State to issue each year:

- The report on the internal control structure used to prepare the general purpose financial statements and to administer federal assistance programs (begins on page 3);
- The reports on weaknesses and instances of noncompliance with state and federal laws and regulations (begin on pages 9 and 53);
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- The report on compliance with federal requirements, including required reports on compliance with laws and regulations related to major and nonmajor federal programs,

and reports on the resolution of prior-year findings related to federal programs (begins on page 47);

- The report on the accuracy of the supplementary schedule of federal assistance (begins on page 169); and
- The report on compliance with state laws and regulations (begins on page 203).

Between July 1, 1995 and December 31, 1996, the Bureau of State Audits issued 60 individual audit reports, many of which discussed needed improvements in the State's operations. These reports are listed in Appendix A and are available to the public through the Bureau of State Audits.

Independent Auditors' Report on the Internal Control Structure

Independent Auditors' Report on the Internal Control Structure

The Governor and Legislature of
the State of California

We have audited the general purpose financial statements of the State of California as of and for the year ended June 30, 1996, and have issued our report thereon dated November 27, 1996. We did not audit the financial statements of the pension trust funds, which reflect total assets constituting 82 percent of the fiduciary funds. We also did not audit the financial statements of certain enterprise funds, which reflect total assets and revenues constituting 86 percent and 90 percent, respectively, of the enterprise funds. In addition, we did not audit the University of California funds. Finally, we did not audit the financial statements of certain component unit authorities, which reflect total assets and revenues, constituting 97 percent and 95 percent, respectively, of the component unit authorities. The financial statements of the pension trust funds, certain enterprise funds, the University of California funds, and certain component unit authorities referred to above were audited by other auditors who furnished their reports to us, and our opinion, insofar as it relates to the amounts included for these funds and entities, is based solely upon the reports of other independent auditors. We have also audited the State of California's compliance with requirements applicable to major federal financial assistance programs and have issued our report thereon dated May 16, 1997.

We conducted our audits in accordance with generally accepted auditing standards; *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Circular A-128, *Audits of State and Local Governments*. Those standards and OMB Circular A-128 require that we plan and perform the audit to obtain reasonable assurance about whether the general purpose financial statements are free of material misstatement and about whether the State of California complied with laws and regulations, noncompliance with which would be material to a major federal financial assistance program. In addition, we are required to review internal controls over nonmajor programs at least once during a three-year cycle.

In planning and performing our audits for the year ended June 30, 1996, we considered the internal control structure of the State of California in order to determine our auditing procedures for the purpose of expressing our opinion on the general purpose financial statements of the State of California, but not to provide assurance on the internal control structure, and on the State's compliance with requirements applicable to major federal financial assistance programs and to report on the internal control structure in accordance with OMB Circular A-128.

The State's management is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded

against loss from unauthorized use or disposition, that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of general purpose financial statements in accordance with generally accepted accounting principles, and that federal financial assistance programs are managed in compliance with applicable laws and regulations. Because of inherent limitations in any internal control structure, errors, irregularities, or instances of noncompliance may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

For the purpose of this report, we have classified the significant internal control structure policies and procedures in the following categories: financial activities, including electronic data processing controls; state compliance; and federal compliance. We did not study the internal control structures for the pension trust funds, certain enterprise funds, the University of California funds, or certain component unit authority funds.

For all of the internal control structure categories listed in the paragraph above, we obtained an understanding of the design of relevant policies and procedures and determined whether they have been placed in operation, and we assessed control risk. Because of the large number of nonmajor programs and the decentralized administration of these programs, we perform procedures to obtain an understanding of the internal control structure policies and procedures relevant to nonmajor programs on a cyclical basis. The nonmajor programs not covered during the current year are subject to such procedures at least once during the three-year cycle.

During the year ended June 30, 1996, the State of California received 97 percent of its total federal financial assistance through major federal financial assistance programs. We performed tests of controls, as required by OMB Circular A-128, to evaluate the effectiveness of the design and operation of internal control structure policies and procedures that we considered relevant to preventing or detecting material noncompliance with specific requirements, general requirements, and requirements governing claims for advances and reimbursements and amounts claimed or used for matching that are applicable to each of the State of California's major federal financial assistance programs, which are identified in the accompanying schedule of federal financial assistance. Our procedures were less in scope than would be necessary to render an opinion on these internal control structure policies and procedures. Accordingly, we do not express such an opinion.

We noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the State's ability to record, process, summarize, and report financial data consistent with the assertions of management in the general purpose financial statements or to administer federal financial assistance programs in accordance with applicable laws and regulations.

We discuss the reportable conditions, present recommendations to correct them, and present management's comments regarding the recommendations on pages 9 through 46 and pages 53 through 150 of our report. Additionally, beginning on page 163, we present a schedule listing instances of noncompliance that we consider to be minor. The reportable conditions identified in the State's single audit report for fiscal year 1994-95 that have not been corrected are included in the sections beginning on pages 9 and 53.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the general purpose financial statements or noncompliance with laws and regulations that would be material to a federal financial assistance program may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of the internal control structure policies and procedures used in relation to the general purpose financial statements or in administering federal financial assistance would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we believe none of the reportable conditions described above is a material weakness.

In addition to the work we performed in accordance with OMB Circular A-128 and the Single Audit Act of 1984, the Bureau of State Audits performed other reviews related to federal programs. A schedule of the pertinent reports issued from July 1, 1995 to December 31, 1996, begins on page 151 of this report.

This report is intended for the information of the governor and Legislature of the State of California and the management of the executive branch. However, this report is a matter of public record and its distribution is not limited.

BUREAU OF STATE AUDITS

PHILIP J. JELICICH, CPA
Deputy State Auditor

May 16, 1997

Internal Control Issues

Opportunities To Increase Revenue

Several departments that we reviewed failed to maximize revenues from various sources. For example, the cash management practices of three departments resulted in lost interest revenue to the State. Loss of legitimate revenues to the State ultimately increases the costs of state programs, which must be funded by other state resources.

Department of Consumer Affairs

Reference Number: 96-1-1

Condition

The Department of Consumer Affairs (department) did not always promptly deposit cash receipts collected by both the Board of Pharmacy (board) and the department on behalf of the board. Specifically, 17 of the 20 cash receipts we reviewed were not deposited within one day of receipt. Twelve of the late deposits were for application and license fees and manually processed renewals that the board collected and remitted to the department for deposit. The remaining five late deposits were for automated renewal fees that the department collected and deposited on behalf of the board. The department deposits cash receipts for numerous boards and bureaus and the majority of the cash receipts are for license fees that are processed by its automated renewal system. The annual amount deposited during fiscal year 1995-96 was \$291 million. If the department experienced delays between two and six days for all of its deposits associated with the centralized cashiering process for renewal fees, which represents approximately 75 percent of its cash receipts, the delays could potentially result in lost interest ranging from \$70,000 to \$200,000. The board and the department recognize that there are delays in the deposit process.

Criteria

The State Administrative Manual, Section 8030.1 (3), requires that daily collections exceeding \$500 in cash or \$5,000 in cash, checks, money orders, and warrants be deposited on the day of receipt. In addition, the State Administrative Manual, Section 8030.1 (4), requires that agencies consider any procedure to expedite depositing to be practical if the additional interest earned will exceed the additional costs of such a procedure.

Recommendation

The board and the department should evaluate their cashiering and deposit procedures to determine the cause of the late deposits and identify ways to ensure that cash receipts are deposited promptly, thus maximizing the State's interest earnings.

View of Department

Both the board and the department agree with this finding. The department states that it is in the process of developing procedures to track the actual date the report of collections is received in the cashiering unit and the promptness of the deposits. In addition, the department states that it will continue to pursue automation efforts to expedite cashiering and remittance processes.

California Department of Education

Reference Number: 96-1-2

Condition

The California Department of Education (CDE) administers the Special Education—Grants for Infants and Families with Disabilities grant under an interagency agreement with the Department of Developmental Services (DDS). The DDS requires the CDE to submit expenditure reports that provide it with information that it needs to draw funds from the federal government to reimburse the State's General Fund. During fiscal year 1995-96, the CDE failed to promptly submit two of the five reports we reviewed. Specifically, the CDE submitted the two expenditure reports 124 and 93 days late, respectively. Similarly, in fiscal year 1994-95, the CDE submitted one expenditure report 208 days late.

Moreover, the CDE submitted two of the three late reports from 84 and 133 days after the State Controller's Office had paid the expenditures from the General Fund. As a result, the DDS was not able to promptly draw down federal funds to reimburse the State's General Fund, thus causing the State to lose potential interest earnings totaling nearly \$190,000.

Criteria

The interagency agreement between the CDE and the DDS requires the CDE to submit expenditure reports to the DDS within certain time frames. The State Administrative Manual, Section 0911.4, requires the CDE to secure prompt reimbursement from grant funds when goods and services are provided.

Recommendation

The CDE should ensure that it promptly submits expenditure reports to the DDS to enable the DDS to minimize the amount of time between payment of state funds and reimbursement of federal funds.

View of Department

The CDE staff administering the early intervention service program (Individuals With Disabilities Education Act, Part H) are working together to ensure that federal funds are drawn down, to the extent possible, at the same time as apportionment payments are made to Special Education Local Planning Areas (SELPA's). The CDE staff are coordinating the submittal of reports to the DDS and claim schedules to the State Controller's Office.

In addition, the CDE is recommending revisions to the 1997-98 interagency agreement with the DDS which will extend the due dates for submission of the first and second invoices to the DDS. The additional time will enable the CDE staff to prepare the invoices on time and allocate funds to SELPA's when federal funds are available for expenditure.

Council for Private Postsecondary and Vocational Education

Reference Number: 96-1-3

Condition

The Council for Private Postsecondary and Vocational Education (council) used incorrect billing information which reduced the approval fees that it was entitled to receive from certain private postsecondary educational institutions (institutions). In two of ten cases we tested for internal controls over cash receipts, the council received underpayments from schools for its fiscal year 1995-96 approval fees. The schools made these underpayments in response to council invoices that were based on incorrect gross revenue data. Due to the errors identified in our testing of internal controls, we expanded our procedures, recalculating all of the annual fee billings for fiscal year 1995-96 and comparing them to the actual fees received. We tested 54 of 325 identified underpayments and determined that annual fees had been underpaid in 31 of the 54 cases for a total of approximately \$73,000. Based on our procedures, we estimate that total underpayments for fiscal year 1995-96 amounted to approximately \$132,000.

The council underbilled some clients because it failed to base annual fee computations on the latest gross revenue data of its client schools. The council used fiscal year 1992-93 gross revenue data to compute billings sent between July and December 1995 and fiscal year 1993-94 gross revenue data to compute billings sent between January and June 1996. In fact, fiscal year 1994-95 gross revenue data was never input to the billing system and was therefore unavailable for use in creating invoices. The council stated that problems related to staffing and the computer system hindered it from obtaining and inputting the most current gross revenue data.

When the council fails to adhere to its adopted fee schedule, it risks underbilling schools for annual fees, thus reducing revenues that could be used to further its programs.

Criteria

The Education Code, Section 94331, requires the council to adopt a fee schedule for all institutions approved under the statute. The fee schedule adopted by the council states that annual fees are to be based on the annual gross revenues derived during the school's last fiscal year ending before the due date of an annual fee payment.

Recommendation

To ensure that it collects all revenue owed, the council should bill schools in accordance with its adopted fee schedule.

View of Department

The following is an abbreviated version of the council's response:

The council agrees with the finding and states that due to several problems with the 1993 and 1994 gross revenues submitted by the schools, in addition to its computer system

deficiencies, a conscious decision was made to bill schools based on old gross revenue data. However, to eliminate billing problems in the future, the council will:

- Design its prospective database so that gross revenues can be entered without a designation for reporting year, when received and tracked by reporting year, rather than entered only after data from all schools has been received; and
- Change its procedures for the current database to focus initial data cleanup efforts on gross revenue data submitted by schools, immediately entering this data once it has been checked.

In addition, the council states that it has emphasized to the schools the correct way to report gross revenues during its annual report training sessions.

Department of Justice

Reference Number: 96-1-4

Condition

The State lost interest earnings of approximately \$7,800 because the Department of Justice (department) billed the Department of Social Services (DSS) late for services provided under the Child Support Enforcement grant. The DSS does not request federal funds for the Child Support Enforcement grant until it receives the department's billings. Thus, when the department's billings are late, the State loses interest. Specifically, the department contracted with the DSS to provide legal and support services for this program starting in July 1995 but did not begin billing the DSS for some of the services until December 1995. The contracts between the department and the DSS were approved in September 1995. However, according to the department's reimbursement management manager, the billings to the DSS were late because the department's accounting office did not receive copies of the approved contracts until December 1995. The Bureau of State Audits reported the same issue in fiscal years 1993-94 and 1994-95. In both instances, we reported that the contracts were approved late.

Criteria

The State Administrative Manual, Section 0911.4, requires state agencies to secure prompt reimbursement from grant funds for goods and services provided.

Recommendation

The department should promptly bill the DSS for the costs of services chargeable to federal grants.

View of Department

The department agrees with our findings. According to the department, in response to the fiscal year 1994-95 audit, it took corrective action to provide timely contracts beginning in fiscal year 1996-97. In addition, the department has taken some steps to promptly bill the DSS, including

signing agreements that cover several years to minimize delays between contract approval, receipt, and billing.

Department of Justice

Reference Number: 96-1-5

Condition

The Department of Justice (department) was not promptly reimbursed for services that it provided to the Los Angeles County Police Chief's Association (LACPCA) under the Drug Control and System Improvement (DCSI) grant. The department invoices the LACPCA monthly for services already provided under the DCSI grant. The invoices are reviewed by the LACPCA and forwarded to the City of Hawthorne for payment. For the 11 fiscal year 1995-96 invoices we reviewed, the length of time between the issuance of an invoice and the receipt of payment averaged 52 days. For example, the department submitted one invoice for approximately \$83,000 to the LACPCA in September 1995 that was not paid until January 1996. Because of the delays in payment for the 11 invoices, the State lost total interest earnings of approximately \$5,500. The Bureau of State Audits reported the same issue in fiscal year 1994-95 and years previous to that.

Criteria

The State Administrative Manual, Section 0911.4, requires state agencies to secure prompt reimbursement from grant funds for goods and services provided.

Recommendation

The department should ensure that it receives prompt reimbursement for its costs of services.

View of Department

The department agrees with our finding. According to the department, it has taken several steps to decrease the time lag between invoicing and reimbursement. According to the chief of the accounting office, for fiscal year 1996-97, the department is billing the LACPCA separately for personnel and operating expenses because the LACPCA does not question the salaries portion of the billings as much as the operating expenses, and salaries make up the largest share of the billings. In addition, the department has eliminated most of the operating expenses from its agreement with the LACPCA, allowing the LACPCA to charge those expenses directly to the grant. Finally, for fiscal year 1997-98, the department has drafted a new memorandum of understanding with the LACPCA requiring payment within 30 days of receipt if the department submits invoices by the agreed cutoff dates.

Cost Savings To Be Achieved

One department we reviewed did not avoid unnecessary costs associated with its programs or administration. The department did not attempt to recover overpayments to providers of supplies for an extended period of time. When unnecessary costs are incurred, the State's limited resources may be diverted from providing essential program goals.

Department of Health Services

Reference Number:

96-2-1

Condition

The Department of Health Services (department) does not have adequate controls to ensure that it promptly corrects overpayments to providers for pharmacy claims, determines the accuracy of certain reimbursement amounts for provider claims, or oversees that provider claim documents are appropriately certified. Because it lacks these controls, the department does not have prompt access to the moneys it is entitled to, cannot prevent overpayments for inaccurate claim amounts, and cannot be assured that it is paying providers for authentic claims.

Recovery of Overpayments to Providers Is Slow

The department did not promptly recover from providers approximately \$2.5 million in overpayments for pharmacy dispensing services the providers rendered between March 1, 1994 and October 23, 1995. Specifically, during our review of payment calculations, we identified one pharmacy claim that was overpaid by \$9.06 because of a coding error in the drug pricing file. After our discovery, the department initiated its process for erroneous payment corrections to determine the total number of claims that were similar to the overpayment that we found. The department identified an additional 357,665 claims representing a net overpayment of approximately \$2.5 million to providers.

In October 1995, the department corrected the coding errors in its automated claims payment system to prevent future overpayments. However, it did not begin taking steps to recover any previous overpayments until October 1996. According to the acting chief of the department's Performance and Change Management Branch, the department delayed the processing of these payment corrections because of increased workload and because it wanted to resolve other coding errors in the automated claims payment system.

The Automated Claims Payment System Cannot Identify Incorrect Co-Payments

The department does not have preventive controls in its automated claims payment system for determining whether a long-term care beneficiary's share of cost, or required co-payment, reported on a claim form agrees with the amount recorded in this system. Although the automated claims payment system contains 16 months of a beneficiary's historical information, including the share of cost, the department does not have an edit in this system to compare the share of cost with the amount reported by the provider. As a result, the department cannot detect in advance those claims that the department should not pay because they contain incorrect amounts. For one

of the two long-term care claims we reviewed, the department overpaid the provider by \$7 because the department did not detect that the provider submitted a claim with an incorrect share of cost.

To make a preliminary determination of the impact of the lack of an edit, the department reviewed a sample of 300 long-term care claims with dates of services in July 1996. Based on its review, the department estimates that between 94 percent and 98 percent of these claims were correctly paid. However, we did not audit the results of this review.

Provider Claim Forms Need the Proper Certification

Finally, for 5 of the 23 provider claims we reviewed, the claim documentation did not contain evidence of the provider's statement and signature certifying the authenticity of the claim information. All 5 providers had claim agreements on file for a different method of claim submission; therefore, these claims should have included a signed provider certification statement with the billing document submitted. We reported a similar weakness during our fiscal year 1994-95 audit.

Criteria

- The California Code of Regulations, Title 22, Section 51458.1(a)(1), states that the department shall recover overpayments to providers including, but not limited to, payments determined to be in excess of program payment ceilings or allowable costs.
- The California Government Code, Section 13401(b)(1), requires that each state agency maintain effective systems of internal accounting and administrative control as an integral part of its management practices. An adequate system of internal controls should include preventive measures, such as automated edits of transactions, to verify the accuracy and reliability of amounts submitted for payment.
- The California Code of Regulations, Title 22, Section 51502.1(f)(5), requires provider certification of all claim document information.

Recommendations

- The department should implement procedures to ensure that it recovers overpayments promptly.
- The department should develop and use computer edits to detect whether the beneficiary's share of cost reported on the provider's claim is accurate.
- The department should ensure that provider agreements on file are current and that the method of claim submission used by providers is appropriate.

View of Department

The acting chief of the department's Performance and Change Management Branch agreed that a significant delay occurred between the identification and correction of the pharmacy claims in

the automated claims payment system and the reprocessing of claims paid before the correction. The department increased the staff hours of its fiscal intermediary contractor to resolve errors in the claims payment system and to correct erroneous claim payments to providers.

The acting branch chief also agreed that long-term care claims could contain incorrect share of cost amounts that the automated claims payment system would not detect. He indicated that the department is currently reviewing its automated payment process for long-term care claims. The department believes that the preliminary results of this review, which includes the sample discussed above, indicate that the problem is minimal. The acting branch chief believes, based on the preliminary results, that preventing the potential for payment error would cost the State a significant amount and disrupt the claim filing process of long-term care providers. The acting branch chief also indicated that the department continues to conduct post-payment audits of long-term care claims. Therefore, the department is not considering any immediate corrective action. However, if the final results of the review indicate that the problem is widespread, the department will consider potential changes to the automated claims payment system for long-term care claims. In either case, the department will issue a reminder notice to long-term care providers describing the process for submitting claims that include share of cost amounts.

The chief of the department's Provider Master File Unit agreed that the department did not have the correct provider agreements for all providers and indicated that, as of November 1996, the department completed and issued to providers a new comprehensive provider agreement that covers multiple methods of claim submission.

Inappropriate Use of Public Funds

During our review, we noted two departments that did not use public funds in accordance with established standards. Because such standards exist to protect the State's resources and assets, failure to follow them may result in their loss.

Department of Transportation

Reference Number: 96-3-1

Condition

The Department of Transportation (department) contracted with the University of California Regents (university) to provide training on behalf of the department. The university has in turn contracted with individual department employees to provide part of that training. Seven department employees we investigated violated the State's Public Contract Code because they were employed by the university under a contract that was ultimately funded by the department. In addition to the wages normally paid, the department paid six of the seven department employees \$3,200 through the department's contract with the university. A seventh employee took leave without pay on the days he worked on the contract, but was compensated \$1,600 through the department's contract with the university. In total, through its contract with the university, the department paid \$4,800 to its own employees. Further, the department paid an additional 10 percent administrative fee (\$480) related to these employees to the university for administering the contract. Consequently, the department paid a total of \$5,280 to the university for its own employees.

According to the State's Legislative Counsel, a civil service employee of the department who, outside of his or her regular employment with the department, contracts with the university to provide training services that are sponsored by the department through its contract with the university is in violation of the Public Contract Code unless those services are required as a condition of the employee's regular state employment. These seven employees were not required to provide the contractual services.

Moreover, the department paid its employees, through its contract with the university, rates greater than it ordinarily paid them. For example, during the period the employees provided the instruction, the seven employees' time was valued at \$2,786, based on their wages as department employees. However, because the department paid \$4,800 to the employees through its contract with the university, the employees received \$2,014 more to teach the classes than they ordinarily earned.

Criteria

The California Public Contract Code, Section 10410, provides that no state employee shall engage in any employment or activity from which the employee receives compensation and which is funded by any state agency or department through a contract unless the employment or activity is required as a condition of the employee's regular state employment.

Recommendation

The department should ensure that its employees are not paid by the contractor for any employment or activity that is funded through a contract with the department.

View of Department

The department agrees with the finding. The department's State and Local Project Development office plans to review the entire arrangement between the university and department employees to make sure it is conforming to applicable codes and sound business practice. At the time the department entered into the contract with the university it believed that department employees were constrained by the fact that participation was to be done on their own time and at their own expense and should not detract from their assigned duties. Six of seven department employees met these conditions. The department will review the case of the employee who did not meet these conditions.

California Highway Patrol

Reference Number: 96-3-2

Condition

The Department of the California Highway Patrol (department) inappropriately paid for contracted services for which it had no authority and continued to receive services under an expired contract. In July 1993, the department entered into a \$124,000 multiyear contract with a vendor for photography services. This contract, and the first amendment to this contract, were properly approved by the Department of General Services (DGS) and required the vendor to provide these services from July 1, 1993 through December 31, 1995.

However, by October 1995, the allocated amount for this contract was exhausted and the department prepared and submitted a second amendment to the DGS for \$20,000. Prior to obtaining the DGS approval for this amendment, the department continued to approve and pay invoices submitted by the vendor. According to the department, the DGS subsequently denied approval of the second amendment, stating that the contract appeared to be a sole-source agreement. As a result, the department paid \$20,000 for services for which it had no authority. In addition, the department continued to receive and was billed for services through January 1996 totaling \$10,800, although the contract had expired December 31, 1995.

The contract manager did not ensure that the department had the necessary authority to pay for and receive the services outlined in the contract prior to allowing the services to be rendered. In addition, the contract manager did not inform the vendor that the department could not further receive the vendor's services until the appropriate approvals from the DGS had been granted.

Criteria

The State Administrative Manual (SAM), Section 8422.1, requires that the department determine whether invoices comply with the provisions of purchase orders, sub-purchase orders, contracts,

leases, service agreements, and similar documents. The SAM also requires the department to determine whether authority existed to obtain the goods or services received.

Recommendations

To comply with the State's contracting process, the department should:

- Ensure that its contract managers are fully aware of their responsibilities for managing contracts; and
- Ensure that it has the authority to pay invoices for goods and services received.

View of Department

The department agrees with the finding and states that it is currently revising its policies to include detailed responsibilities for contract managers, particularly in monitoring contract spending levels against the provisions of the contract. Furthermore, the department states that while it considers this contract issue to be an isolated incident, it will reinforce its existing practices of reviewing contracts prior to payment.

Areas in Which Operational Efficiency Is Limited

Although our review was not specifically designed to identify inefficient practices, we noted operational inefficiencies at two departments. Included in these inefficiencies was one department that incurs administrative expenses on collection activities that are unlikely to result in the collection of amounts owed.

California Highway Patrol

Reference Number: 96-4-1

Condition

The Department of the California Highway Patrol (department) inappropriately used its Office Revolving Fund (ORF) to pay vendors during the 1995-96 fiscal year in order to compensate for inefficiencies in its invoice-processing system. Specifically, of the 39 ORF disbursements we reviewed, 14 did not meet the "permissible uses" criteria for the ORF. In addition, the department failed to take advantage of \$4,851 in vendor discounts for 3 of these 14 items.

For 9 of the 14 disbursements, the department used the ORF to either prevent penalties from accruing or to prevent additional penalties from accruing on past-due invoices. For the remaining 5 exceptions, the department could not substantiate the use of the ORF as opposed to the normal claim-processing procedure which requires departments to remit claim schedules to the State Controller's Office for payment. In addition, the department failed to take advantage of discounts offered by vendors because it did not expedite the payments for discounted invoices. The department may continue to incur penalties from past-due invoices unless the department's statewide area offices and its accounting office improve claim-processing procedures to allow for the issuance of payments to its vendors in a timely manner.

Criteria

The State Administrative Manual, Section 8110, states that revolving funds drawn may be used only for payment of compensation earned, traveling expenses, traveling expense advances, or where immediate payment is otherwise necessary. In determining whether immediate payment is necessary, the determining factor is whether payment could be made through the normal claim-processing procedure and with a State Controller's Office warrant issued.

In addition, Section 8113 states that invoices will be paid by revolving-fund checks only when a discount of at least \$5 can be taken and where the discount percentage is at least one-half of one percent, and when the discount period is too short to permit taking advantage of the discount if payment is made by warrant.

Recommendations

To comply with the ORF policies outlined in the State Administrative Manual, Section 8100, the department should:

- Improve its claims-processing procedures by ensuring that its area offices approve and submit invoices for payment to the accounting office in a timely manner and that its accounting office processes such invoices in a manner which allows for payment prior to the due date; and
- Take advantage of discounts offered by vendors.

View of Department

The department agrees with the finding and, as a result, has instituted tighter controls over the use of the ORF. Specifically, the department states that it will restrict ORF payments to discounted invoices, salary advances, travel advances, and travel expenses, as well as require accounting section managers to approve these payments prior to issuance.

The department also states that it will release statewide corrective advisories requiring area offices to submit invoices to its accounting section within three business days after receipt to ensure prompt processing. Furthermore, the department states that its policy is to take advantage of discounts offered by vendors. However, in those instances in which discounts are not taken, it generally considers them to be oversights rather than the result of a lack of procedures.

Department of Real Estate

Reference Number: 96-4-2

Condition

The Department of Real Estate (department) incurs administrative expense on collection activities that are unlikely to result in the collection of amounts owed. The department reported over \$14 million in uncollectible accounts receivable as of June 30, 1996, that were related to payments from the Real Estate Recovery Account. The account, an account within the Real Estate Fund, is used as a last resort for people who have been defrauded by real estate licensees in connection with acts requiring a real estate license.

The account is funded by 12 percent of all license fees collected. Prior to applying for a claims payment from the account, a claimant is required to obtain final court judgment based on the licensee fraud and the licensee's inability to pay the judgment, which is determined through an asset search. The claimant may file a claim against the account up to \$20,000 for any one transaction and \$100,000 for any one licensee, the maximum amount allowed by law.

When claims are paid out of the account, the license of the licensee is automatically suspended, and his or her name is flagged in the department's license database until the account has been repaid with interest. In addition to these automated records of amounts owed, the department establishes an accounts receivable in its accounting records equivalent to each of the amounts

owed. For example, we noted that there were 415 entries in the department's accounts receivable subsidiary. While these receivables may be valid, and the department assumes the judgment creditor's rights, they are not considered collectible as established by the final court judgments.

The department's accounting staff prepare and mail collection letters as required by state administrative practices, and as is reasonable in most circumstances. While other collection efforts have yielded less than a 1 percent collection rate, the department has received no benefit from the collection letters. Specifically, it estimates that its collection efforts using the services of the Franchise Tax Board and flagging the debtor's name in its licensing database have yielded less than a 1 percent collection rate. In addition, according to the department, during the fiscal year it received approval from the Board of Control to write off approximately \$7 million in uncollectible receivables. This assisted the department in reducing the uncollectible accounts receivable balance to the \$14 million existing as of June 30. The department's establishment of receivables for payments that are remotely collectible in addition to records already maintained in its license database causes increased workload for its accounting staff.

Criteria

State Administrative Manual, Section 8776.6, provides guidelines for the collection of nonemployee accounts receivable. It requires departments to send three collection letters to the last known address of the debtor. If the collection letters are unsuccessful, the process moves to the next phase, which requires departments to prepare an analysis to determine what additional collection efforts should be made. The analysis should include a cost/benefit analysis of the collection actions such as: offset procedures, court settlements, collection agencies, and sales accounts receivable.

Recommendation

Because of the extremely low recovery rate on its efforts to collect on judgments against licensees who are identified in its licensing database, the department should seek a permanent exemption from the Department of Finance to discontinue establishing a receivable in its accounting records when it pays a claim. The exemption should also be sought to minimize the department's collection efforts to the existing offset procedures allowed by the State.

View of Department

According to the department it will continue seeking approval to obtain relief of accountability on the balance of outstanding recovery accounts receivable.

Inaccurate Financial Information

We found five problems at three departments that resulted in actual or potentially inaccurate financial information being submitted to state policy makers. For example, the Department of Health Services overstated Federal Trust Fund assets and liabilities by \$1.3 billion, and the Council for Private and Postsecondary and Vocational Education does not account for revenues and expenditures of \$152,000 as required by statute.

Department of Health Services

Reference Number: 96-5-1

Condition

The Department of Health Services (department) did not accurately prepare its fiscal year 1995-96 financial reports for the Health Care Deposit Fund and the Federal Trust Fund. As a result, at June 30, 1996, the department overstated by approximately \$1.3 billion the receivable and liability accounts for both funds and also overstated the revenues and expenditures for the Federal Trust Fund.

The department incorrectly prepared its accrual because it failed to estimate costs associated with certain appropriations for the Medical Assistance Program for fiscal years 1992-93 through 1994-95. Instead, the department based its accrual on the remaining balance in these appropriations at June 30, 1996. For example, the department recorded the entire remaining balance of \$708 million for the accruals related to the 1992-93 and 1993-94 appropriations for county administration costs for the Medical Assistance Program. However, representatives from the department's legal counsel and federal liaison units estimated that the department would pay only \$54 million of its reported year-end accrual, specific to fiscal year 1992-93 and 1993-94 appropriations. Similarly, because it failed to estimate costs correctly, the department overstated by \$686 million the accruals for county administration costs related to the Medical Assistance Program for the fiscal year 1994-95 appropriation.

Failure to analyze and provide accurate financial information to the State Controller's Office reduces the State's ability to prepare financial statements that are in conformity with generally accepted accounting principles. Many groups, including the State Legislature and the general public, rely on accurate financial statements. Such errors by the department could significantly distort the State's financial statements. The department should have recognized these errors because its accrual was nearly twice the amount reported the previous year. Also, in our prior-year audit, we reported a similar weakness in the department's financial statements.

Criteria

The State Administrative Manual, Section 10608, requires state agencies to record as liabilities only those amounts relating to valid obligations as of June 30. In addition, the State Administrative Manual, Section 8776.2, requires state agencies to record as valid receivables all amounts that are due and payable to the agencies and, at June 30, to accrue those receivables that the agencies expect to collect within the next fiscal year.

Recommendation

To ensure that it submits accurate financial information to the State Controller's Office, the department should base its accruals on reasonable estimates and on valid obligations and receivables.

View of Department

The acting chief of the department's Financial Management Branch agreed with the finding and notified the State Controller's Office to adjust the State's financial statements for the Health Care Deposit Fund and the Federal Trust Fund. The acting chief stated that the department will analyze the accrual more closely during the year-end closing process by comparing prior-year accruals to current-year accruals. In addition, the accounting section will use the estimates for the current-year and prior-year accrual prepared by the department's Fiscal Forecasting and Data Management Branch.

Department of Housing and Community Development

Reference Number: 96-5-2

Condition

Although the Department of Housing and Community Development (department) has improved its control over loans distributed from the California Disaster Housing Rehabilitation Fund (fund 689), the Housing Rehabilitation Loan Fund (fund 929), and the Rental Housing Construction Fund (fund 938), some deficiencies remain. During our review of fiscal year 1995-96, we found the department did not reconcile all differences in its accounting and program records, and could not provide all of the supporting documents for reconciliations of loans receivable. In addition, the department cannot assure that necessary adjustments have been posted to the accounting records. Furthermore, the department lacks a central filing system for its reconciliation documents and a tracking system to ensure that adjustments that result from reconciliations are posted to its accounting records. As a result, the department cannot ensure that its housing loan records are complete and accurate and that public resources invested in housing loans are adequately safeguarded.

In prior years, we reported the department did not reconcile loans receivable balances in its accounting and program records for the three funds. To address the issue, the department hired an independent CPA firm to resolve differences in the balances and prepare procedures for monthly reconciliations of the records. The department began reconciling loans receivable balances for its accounting and program records in the quarter ending March 31, 1996. However, during our fiscal year 1995-96 audit, we found the department failed to identify all of the differences between the records. In addition, the department could not provide some supporting documents for the required reconciliations and adjustments. Further, we noted that the department performed the reconciliations on a quarterly, rather than a monthly, basis as described in the procedures prepared by the CPA firm.

We reviewed the department's reconciliations of loans receivable balances in its accounting and program records for the quarters ending March 31, 1996, and June 30, 1996. We found the

department had not identified all of the differences between the records. For example, in the March 31, 1996 reconciliation, the department had not identified differences ranging from \$249 to \$78,460 for 4 of the 19 loan accounts we reviewed from fund 689. In addition, the department could not provide all of the documentation to support its resolution of the differences in some of its loan account balances. Specifically, the department could not provide documentation for 4 of 19 loan accounts for fund 689, 19 of 93 loan accounts for fund 929, and 1 of 14 loan accounts for fund 938. Similarly, for the June 30, 1996 reconciliations, the department could not provide documentation for 1 of 65 loan accounts from fund 929, and 5 of the 13 loan accounts from fund 938.

After program staff members perform the reconciliations of loans receivable balances for the accounting and program records, they forward the identified adjustments to the accounting unit where the adjustments are posted to the department's accounting records. Accounting staff members are required to sign the reconciliation documents as evidence they posted the adjustments and return the reconciliation documents to the program unit. However, we found that the accounting staff members did not always sign the reconciliation documents. For the quarter ending March 31, 1996, 8 of 71 reconciliation documents we reviewed for fund 929, and 5 of 13 we reviewed for fund 938, lacked signatures confirming that adjusting entries had been posted to the department's records. In addition, for the quarter ending June 30, 1996, 26 of 62 reconciliation documents we reviewed for fund 929, and 1 of 8 we reviewed for fund 938, lacked confirming signatures. When accounting staff fail to sign reconciliation documents, program staff members who prepare the reconciliations cannot determine whether the adjustments have been posted.

Criteria

The California Government Code, Sections 13401 and 13403, require agencies to maintain an effective system of internal control, which includes accurate record-keeping procedures for assets, liabilities, revenues, and expenditures. In addition, the State Administrative Manual, Section 7900, prescribes preparing monthly reconciliations to ensure that transactions have been processed properly and that financial records are complete.

Recommendation

To improve its controls over loans receivable balances, the department should take the following steps:

- Perform reconciliations of the loans receivable account balances in its accounting and program records on a monthly basis rather than a quarterly basis;
- Create a central filing system for documentation used to prepare the reconciliations; and
- Establish a tracking system to ensure that staff post adjustments to the department's records and store supporting documentation in a retrievable manner.

View of Department

The department agrees with the findings and provided the following comments. The department has implemented most of the CPA firm's reconciliation guidelines and procedures provided in January 1996. Since it completed its first reconciliations in March 1996, the department has made significant progress in identifying and resolving differences in the loans receivable account balances reported in its program and accounting records. As a result of its new procedures, the department corrected 99 of 126 outstanding items identified in the reconciliation prepared for the quarter ending December 31, 1996. In addition, the department will develop a tracking system to ensure that its records are adjusted for all identified items from the reconciliations. It will also establish a consistent filing system to provide easier access to the reconciliation spreadsheets and back up information. These improvements should be in place during fiscal year 1997-98. Finally, the department plans to seek an exemption from the Department of Finance to allow for quarterly reconciliations because it believes monthly reconciliations slow the reconciliation process and do not provide any measurable safeguards or other advantages.

Department of Housing and Community Development

Reference Number: 96-5-3

Condition

The Department of Housing and Community Development (department) needs to improve its accounting of the transactions of the Mobilehome Park Resident Ownership Program (MPROP). As a result of deficiencies noted in the department's accounting for MPROP loans, we found that the actual revenues generated and the actual costs of operating the MPROP are unknown to policy makers. Specifically we found the following:

- The department does not maintain loan amortization schedules for loans with deferred payment status and, as a result, it is unable to determine the interest earned on these loans. Specifically, according to the department, the majority of the loans funded by the MPROP are originated with note terms allowing the payment of principal and interest to be deferred for the full term of the loans. The department calculates the interest for those loans that are in deferred payment status only when the loan matures. The department neither accrues interest nor does it disclose the number of these loans outstanding and the related interest income that would have been earned if they were not deferred to state policy makers prior to maturity.
- According to the department, it does not periodically evaluate its loan portfolio nor has it established an allowance for loan losses account. The allowance for loan losses is an estimated amount of losses in a loan portfolio that the department considers to be adequate to cover the estimated losses inherent in its loan portfolio which is charged to operating expenses. As a result of not recording the allowance in the financial statements, the department has understated the expenses of the MPROP.
- The department failed to promptly write off loans that it deemed uncollectible. Specifically, we noted 11 loans with a principal loss totaling \$124,672 that the department deemed uncollectible during the period from February 1994 to June 1996. Although the department had prepared the applications for discharge from accountability for these loans, it had not

submitted the applications to the Board of Control for write-off approval. As a result, the department has understated these expenses of the MPROP as well.

- Finally, we noted that the department failed to reclassify as accounts receivable five loans totaling \$118,942 that, according to the department, became due and payable prior to 1993, because the borrowers have either died or are no longer residing on the property. Without proper identification of the loans that have become due and payable, the department can not effectively follow up on the repayment of its loans. Further, the department's delays in the following up on the loans increases the risk of uncollectible loans.

Criteria

The California Government Code, sections 13401 and 13403, requires state agencies to maintain an effective system of internal control which include record-keeping procedures to provide effective accounting controls over assets, liabilities, revenues, and expenditures.

Recommendation

To ensure that loans receivable are properly accounted for, the department should:

- Maintain loan amortization schedules for mobile home park purchase ownership loans with deferred payment terms and disclose the number of these loans outstanding and the related interest income that would have been earned if they were not deferred to state policy-makers;
- Maintain an allowance for loan losses through periodic charges to operating expenses. The allowance should be adequate to cover specifically identified loans as well as loans for which losses are probable but not specifically identifiable. The department should evaluate the amount of estimated losses and adjust its allowance annually. Factors to be considered when analyzing its portfolio for uncollectible loans include, but are not limited to, the department's previous collection experience with its loans, changes in real estate market trends, and the fair market value of the collateral for its loan portfolio in relation to the loan amounts;
- Obtain the Board of Control's approval to write off the amount of loans that are deemed uncollectible; and
- Reclassify as accounts receivable the portion of loans that have become due and payable.

View of Department

The department generally concurs with all the recommendations. The department states that beginning with its 1996-97 year-end financial statements, it will reclassify those loans that have become due and payable from long-term to short-term status, estimate losses on its loan portfolio, and establish an allowance for loan losses which will be reviewed annually. Moreover, the department will begin developing amortization schedules for all of its loans starting with MPROP and anticipates that amortization schedules for MPROP loans will be developed by the end of fiscal year 1997-98.

Council for Private Postsecondary and Vocational Education

Reference Number: 96-5-4

Condition

The Council for Private Postsecondary and Vocational Education (council) does not record billed receivables that remain outstanding at year-end as revenue, nor does it record revenues unearned at year-end as advance collections. As a result, the council did not always record revenues for the period in which they were earned, as required by generally accepted accounting principles and state administrative procedures.

The council understated the 1995-96 fund balance by approximately \$152,000 because it did not accrue accounts receivable and revenues at year-end, and it did not classify unearned revenues as advance collections rather than revenues.

Criteria

The State Administrative Manual (SAM), Section 8290, requires that income, as represented by billed accounts receivable earned but not received, be accrued in the same year if the accounts receivable are estimated to be collectible by the end of the next fiscal year. Such amounts are considered earned as of June 30 of the year just ended. In addition, SAM Section 8210 requires that revenue collected in advance, received on or before June 30 but not earned as of that date, be reported as revenue collected in advance, a liability account.

Recommendation

We recommend the council establish procedures for accruing accounts receivable and revenues at year-end, and for recording unearned revenues as advance collections. Such procedures may include analysis of billings outstanding at year-end, analysis of fee payments subsequent to year-end, and analysis of the service year associated with fees received during the year.

View of Department

The following represents an abbreviated version of the council's response:

The council agrees with the finding. However, it states that since its current computer system was not designed to associate payments received with a given due date, it would be very labor intensive to develop a breakout of revenues by fiscal year. Further, due to the governor's veto of legislation extending its life and the resulting departure of its staff, the council's accounting functions have been returned to the contracted fiscal services (CFS) unit of the Department of General Services. Neither the council nor the CFS is currently tracking accounts receivable, nor does the council have the resources to do so manually.

Council for Private Postsecondary and Vocational Education

Reference Number: 96-5-5

Condition

The Council for Private Postsecondary and Vocational Education (council) did not allocate fees and expenditures between a subaccount for degree-granting institutions and a subaccount for vocational education institutions within the Private Postsecondary and Vocational Education Administration Fund (Fund 305), as required by statutes. Without deposit of fees and allocation of expenditures to required subaccounts, the council is unable to determine if approval fees and federal funding are adequate to cover expenditures attributable either to degree-granting or to vocational education institutions.

Council staff stated that data system and staffing constraints had not allowed the use of special subaccounts on a cost-effective basis. The council did not begin developing procedures for depositing fees and allocating expenditures on a special subaccount basis until fiscal year 1996-97.

Criteria

The Education Code, Section 94304(g), requires that all fees derived from postsecondary degree-granting institutions and related veterans' education benefits be deposited to a special degree-granting institution subaccount within Fund 305. Similarly, all fees derived from vocational education institutions and related veterans' education benefits are to be deposited to a special vocational education subaccount within Fund 305. This section also requires that staff time used to approve degree granting and vocational education institutions be charged to the appropriate subaccount. In addition, general administrative expenses are to be allocated to the appropriate subaccounts on a pro rata basis.

Recommendation

We recommend that the council implement procedures for depositing fees and allocating expenditures to special accounts in the Private Postsecondary and Vocational Education Administration Fund.

View of Department

The following represents an abbreviated version of the council's response:

The council agrees with the finding and states that in the past expenditure data was not captured in a way that allowed for the association of expenditures with revenues by subaccount. The council states that it has now established processes for reporting revenues and expenditures by subaccount. However, due to the governor's veto of legislation extending its life and the resulting departure of its staff, the council does not have the resources to implement the new procedures.

State Controller's Office
Department of Finance

Reference Number: 96-5-6

Condition

The State Controller's Office (SCO) and the Department of Finance (DOF) report on the State's budgetary basis financial condition using different accounting practices that may result in different fund balances for many of the State's funds; however, neither the SCO nor the DOF consistently reconciles these discrepancies. We compared the SCO and DOF fiscal year 1995-96 fund balances for five funds and noted discrepancies in all five instances, ranging from approximately \$44,000 to \$388.6 million. For example, the SCO reported a General Fund balance of \$1.074 billion and the Governor's Budget, prepared by the DOF, reported a General Fund balance of \$685.4 million, a difference of \$388.6 million for the same reporting period. In addition, the SCO reported a fund balance in the Air Pollution Control Fund of \$11 million, while the DOF reported a fund balance of \$2.2 million, a difference of \$8.8 million. While the SCO and DOF reconciled the fiscal year 1995-96 General Fund discrepancies, they did not complete the reconciliation until April 10, 1997. Moreover, neither the SCO nor the DOF reconciled the differences in fund balances for the remaining four funds we reviewed.

Inconsistent accounting practices and the resulting differences in fund balances provide the financial decision makers and the investment community with conflicting information about the State's true financial condition. For example, because the DOF's records are used in the State's budgeting process, the inability to account for the differences adequately may impair the integrity of the State's budget. In addition, the State Treasurer's Office discloses in its prospectus for the sale of state bonds that the SCO and the DOF use different accounting practices. The disclosure is important because the schedules prepared by the two entities, which are included in the prospectus, do not agree.

Criteria

The California Government Code, Section 13403, discusses the importance of a satisfactory system of internal accounting and administrative controls. These controls help provide reasonable assurances regarding the accuracy of accounting data. In addition, the State Administrative Manual, Section 7900, discusses the importance of preparing regular reconciliations.

Recommendation

Because of the need for accurate and consistent financial information, the DOF and the SCO should reconcile differences that exist in reports of the budgetary basis fund balances.

View of Department

We reported this issue previously, and the DOF responded that it works closely with the SCO to reconcile major differences between its own budget documents and the SCO's preliminary reports. However, parent departments for special funds have the primary responsibility for preparation of the Fund Condition Statements to be included in the Governor's Budget.

Various State Departments

Reference Number: 96-5-7

Condition

The State has inadequate procedures to ensure that the Department of General Services' (DGS) Statewide Real Property Inventory incorporates all real property transactions as recorded in state agency accounting records. Specifically, state agencies are not required to reconcile the amount they reported for the Statewide Real Property Inventory to the amount they report in their Statement of Changes in General Fixed Assets. Unless the agencies reconcile the cost information in the two documents, the State may not maintain a complete and accurate inventory of all its real property and the amounts reported in the State's financial statements may not agree with the Statewide Real Property Inventory.

Criteria

The California Government Code, Section 11011.15, requires the DGS to maintain a complete and accurate inventory of all real property held by the State. It also requires each agency to furnish the DGS with a record of each parcel of real property that it possesses and to update its real property holdings by July 1 each year. Further, the State Administrative Manual, Sections 7977 and 8660, requires agencies to report all additions and improvements to real property funded by government resources.

Recommendation

Because of the need for accurate financial information, the State should require agencies to reconcile their real property inventory to their annual Statement of General Fixed Assets.

View of Department

We have previously reported this issue and the Department of Finance stated that during the review of required year-end reports, it would consider requiring departments to reconcile the amounts reported in the Statewide Real Property Inventory with their Statement of General Fixed Assets. In addition, in January 1997, the Department of Finance requested state agencies to develop and submit corrective action plans and related costs to remedy statewide internal control weaknesses, including this weakness in real property inventory.

Miscellaneous Control Weaknesses

We found seven control problems at three departments that resulted in assets not being protected, employees not receiving leave credit to which they were entitled, or programs not operating as required by statute. For example, payments for airline tickets and postage were not reconciled to airline tickets and postage purchased, and housing loans were not made according to statutory requirements.

Department of Housing and Community Development

Reference Number: 96-6-1

Condition

The Department of Housing and Community Development's (department) administration of the Mobilehome Park Resident Ownership Program (MPROP) requires improvement. The department has been administering the MPROP since 1984. The purpose of the program is to provide supplemental financing to make it possible for mobile home park residents to acquire the mobile home parks in which they reside and convert them to resident ownership.

We reviewed 9 of the 21 loans disbursed in fiscal year 1995-96 for the MPROP and noted the following deficiencies:

- For four of the nine borrowers, the department approved loans which exceeded the provisions of the program. Specifically, the statutes allow loans for up to 50 percent of the acquisition costs; however, under certain conditions, loans can be granted for up to 95 percent of the acquisition costs. We found that three of the loans exceeded 95 percent of the acquisition costs by 3 to 5 percent and the other loan exceeded 50 percent of the acquisition costs by less than 1 percent. Misinterpretation of the statutes, less than prompt review of the eligibility files, and failure to obtain sufficient documentation to waive the 50 percent financing limitation have contributed to the department's noncompliance. In addition, the loan origination and underwriting guidelines provided to the loan originators, which contain a loan summary form, do not specify the conditions necessary to allow loans up to 50 percent and 95 percent of the acquisition costs.
- For one of the nine borrowers, the department required a monthly payment that caused the borrower's post-conversion housing costs to exceed both 40 percent of her monthly income and pre-conversion housing costs. Post-conversion housing costs are the borrower's monthly housing expenses prior to purchasing the residence that have been adjusted for expenses related to the purchase, such as mortgage payments to other lenders and the department. The regulations require that the post conversion housing costs are not to exceed the greater of 40 percent of the resident's gross monthly income or the resident's housing costs prior to the conversion. The department failed to change its calculations when a co-borrower, who was no longer residing on the property, was removed from the application, in accordance with the Health and Safety Code, Division 31, Section 50780, which requires the borrowers to reside on the property.

- For two of the nine loans, the department failed to secure pertinent documents to support the disbursement of MPROP funds. For example, the department was unable to locate security and pledge agreements and closing escrow statements. Further, in one instance, it did not have sufficient documents in the loan files to verify that the borrower's loan amount did not exceed 50 percent of the conversion costs attributable to low income spaces. The department's untimely review of loan files and its deficiencies in communication with loan originators contributed to the lack of properly documented loan files.
- Our review indicates that in six of the nine, or 67 percent, of the files reviewed, the contracted loan originators either did not compute the loan amount correctly or failed to provide the department with the proper loan documents after the close of escrow. In our opinion, due to the high percentage of errors noted, it would be beneficial to the department to invest the financial resources to substantially reduce these errors. The department receives an annual registration fee of \$5, for each transportable section of a manufactured home or mobile home, which is to be used solely for the disbursement of loans and its administrative costs. In addition, it receives interest income from loans and investments. For fiscal year 1995-96, although the department collected \$1,781,730 in fees and spent \$981,838 and \$724,555 on the disbursement of loans and administrative costs, respectively, the MPROP had a cash balance of approximately \$9.5 million at year end. In our opinion, since the eligibility criteria established by the statutes for the MPROP are complex and the number of loans disbursed is relatively low, the department should use MPROP funds to reduce the administrative errors identified in the loan origination process.

Further, we noted the following deficiencies in the overall administration of the MPROP:

The department inappropriately allowed a five-month grace period which reduced the borrower's monthly housing costs below the 30 percent allowed by statutes. Specifically, the statutes prohibit the use of MPROP funds to reduce monthly housing costs for low-income residents to less than 30 percent of their monthly incomes. Further, the statutes make no provision for a grace period. The department generally allows a 60-day grace period before requiring a borrower to start the payment of principal and interest if the borrower's housing costs are to be reduced below 30 percent of his monthly income because he pays off another lender's loan on the mobile home.

In addition, the department does not have procedures in place to ensure that an individual borrower's monthly housing costs are at least 30 percent of his monthly income throughout the life of the loan. Specifically, the department approves individual loans with deferred loan payments based upon income information obtained when the loan is originated and does not require or perform periodic income verification to ensure that the borrower's existing housing costs are at least 30 percent of the borrower's income and warrant the continued deferral of loan payments. The department states that it interprets the statutes to require the borrower's monthly housing costs to be at least 30 percent of the monthly income only at the time of loan closing. Although the statutes allow the department to establish flexible repayment terms, they clearly prohibit the use of these funds to reduce monthly housing costs to less than 30 percent of the borrower's monthly income.

Also, the department failed to obtain the Department of General Services' (DGS) approval for all its loan origination service contracts entered into with mortgage lenders to provide services such

as processing loan applications, verifying income and housing costs, and preparing loan documents. The department obtained an exemption from DGS for its standard agreements with local public entities and resident organizations. However, it misinterpreted the exemption and considered the mobile home loan origination service contracts to be exempt from DGS approval as well.

Finally, the department provided inaccurate information to its loan originators. Specifically, in its loan origination and underwriting guidelines, which contain a loan summary form, the department states on the loan summary form that “to be eligible for MPROP assistance, the household’s annual gross income cannot exceed 80 percent of the lower income limit, by household size, for the county of residence.” However, the statutes allow the use of MPROP funds to assist low-income residents whose annual gross incomes are at 80 percent of the median income limit. We are unable to determine the number, if any, of the applicants who may have been denied MPROP funds as a result of this error.

Without adequate administrative control, the department cannot ensure that all loans are provided only to eligible borrowers at correct amounts, and that it has adequately secured all the related loan documents from its loan originators.

Criteria

The California Government Code, Section 13401, requires agencies to maintain an effective system of internal accounting and administrative control as an integral part of its management practices to reduce errors in state programs.

The California Health and Safety Code contains specific program requirements as follows:

Section 50784(d) dictates that loan amounts for individual loans, to the extent possible, shall not exceed 50 percent of the acquisition costs. The department may approve loans with loan amounts up to 95 percent of the acquisition costs only when the borrower has demonstrated that he has unsuccessfully sought additional funding from other sources and would be unable to purchase the individual interest in the mobile home park without a waiver of the 50 percent financing limitation. In addition, Section 50784(e) dictates, with limited exceptions, that loan amounts for loans provided to resident organizations shall not exceed 50 percent of the conversion costs attributable to the low-income spaces.

Section 50786(b) directs the department to obtain the best available security for a loan such as a note, deed of trust, assignment of lease, or other form of security on real or personal property that the department determines is adequate to protect the interest of the state.

Section 50784(f) dictates that mobile home park purchase funds shall not be used to reduce monthly housing costs for low-income residents to less than 30 percent of their monthly incomes.

The California Code of Regulations, Section 8002, requires that post-conversion housing costs shall not exceed the greater of 40 percent of the borrowers’ gross monthly incomes or their housing costs prior to conversion.

The California Public Contract Code, Section 10295, states that, unless otherwise exempt, contracts entered into by any state agency for the purchase of equipment, supplies, materials, services, or construction are void unless or until approved by DGS.

The California Health and Safety Code, Section 50079.5, establishes income limits for lower income households at 80 percent of the median family income of a particular geographic area.

Recommendation

To ensure that loans are provided only to eligible borrowers at correct amounts for their intended purposes and that they are adequately secured, the department should:

- Require contracted loan originators to submit all eligibility files to the department for final approval before the close of escrow and review the files to ensure that income and housing costs have been properly verified and that loan amounts and monthly payments have been correctly determined in accordance with the laws and regulations. We recommend that the department perform this procedure until the administrative errors in the loan origination process are substantially reduced. Subsequently, it can implement alternative methods such as random spot checks on selected loans and the simplification of its loan origination forms to ensure that the errors remain at a relatively low level;
- Review the loan files immediately after the close of escrow to ensure that all loan and security documents have been received and to verify that the actual loan amount does not exceed the amount approved by the department;
- Revise its loan origination and underwriting guidelines to eliminate the allowance of a 60-day grace period;
- Seek a legal opinion to determine whether the statutes require the borrower's monthly housing costs to be at least 30 percent of his monthly income only at the time the loan closes;
- Ensure that it obtains DGS approval for its loan origination service contracts; and
- Revise the loan summary form contained in its loan origination and underwriting guidelines to correct the eligibility requirements for lower income households to 80 percent of the median income limit and to include the 50 percent and 95 percent acquisition cost requirement.

View of Department

The department generally concurs with the recommendations. Specifically, the department states that it has made a concentrated effort during the past 18 months to eliminate the backlog of unreviewed loan files and will continue its efforts to review loan files promptly. In addition, it will revise the MPROP loan summary forms immediately to correct the eligibility requirements and to include the 50 percent and 95 percent acquisition cost requirement. Further, it will eliminate the allowance of a 60-day grace period and develop a procedure to require the borrowers to notify the department if there is a need to delay starting their MPROP payments.

Finally, it will seek an exemption from DGS for loan origination contracts and will forward the contracts to DGS for approval until the exemption is granted.

However, the department believes that requiring it to review and approve all loan transactions prepared by its loan originators prior to the close of escrow defeats the purpose of using contract loan origination services and states it will investigate alternative methods to reduce the frequency of errors noted. Alternative methods include, if feasible to administer, random spot checks on selected loans prior to funding; review of and revision to, as appropriate, the loan origination forms used by contract loan originators to simplify the required calculations; and the development of criteria to be used in circumstances under which the department would withhold loan origination fee payments until the errors made by contract loan originators are corrected.

The department states that it interprets Section 50784(f) to require the borrower's monthly housing costs to be at least 30 percent of his monthly income to be in effect only when the loan closes and will seek a legal opinion to determine whether this statute requires ensuring that the borrower's housing costs are least 30 percent of his monthly income over the term of the loan.

Department of Housing and Community Development

Reference Number: 96-6-2

Condition

The Department of Housing and Community Development (department) has been administering the state's Mobilehome Park Resident Ownership Program (MPROP) since 1984; however, according to the department, prior to November 1996, it did not have procedures in place to monitor periodically the loans made to individual borrowers. Specifically, according to the department, its owner loan management unit first started to monitor loans in November 1996 by conducting a survey of the 329 outstanding loans and found that 18 of these borrowers no longer resided on the property. The department's efforts entailed contacting the 20 homeowner associations for the mobile home parks of its borrowers and requesting copies of their occupancy rolls. The department compared its records against the associations' lists and identified the 18 items mentioned above. Our review of the department's monitoring revealed that as a result of its inaction prior to November 1996, the department has jeopardized its security interest in 18 loans totaling approximately \$323,000, plus accrued interest. Specifically we found the following:

- For 6 of the 18 loans, totaling approximately \$106,000, the borrowers had died and the department had not proceeded with contacting the borrowers' heirs for total payment of its loans plus accrued interest;
- For 5 of the 18 loans, totaling approximately \$110,000, the borrowers had either sold or had made plans to sell their properties without the department's knowledge, and as a result, for those that had been sold, the department had not received its portion of the proceeds;
- For 4 of the 18 loans, totaling approximately \$45,000, other lenders to the borrowers foreclosed on the property without the department's knowledge. Further, in one instance, we noted that the other lender had a security interest in the property that was subordinate to the department's; and

- For the remaining 3 of the 18 loans, totaling approximately \$62,000, the borrowers had rented their properties without the department's knowledge. This is in violation of Health and Safety Code, Division 31, Section 50780, which requires the borrower to reside on the property.

According to the department, it is negotiating the repayment of the loans with estate administrators or heirs of deceased borrowers, with borrowers who have rented out their mobile homes and with the homeowner associations where units have been sold, to recover all or a portion of the \$323,000, plus accrued interest. It is the department's intent to continue its annual monitoring. However, in our opinion, the benefit to the department of monthly or quarterly monitoring to ensure that its security interest in its loans is not jeopardized outweighs the cost of its current monitoring procedures. The cost to the department of contacting 20 homeowner associations and comparing the lists of residents is small compared to the risk of loss that increases as time passes between borrowers' deaths, foreclosure proceedings, etc. and notification to the department.

In addition to the 18 items discussed above, we identified another instance where one borrower had passed away in January 1996 with an outstanding principal amount of \$41,144. Although the MPROP loans are not assumable, the department's financial management branch continued to bill the deceased borrower and received monthly payments from the deceased borrower's daughter. The department has in effect allowed the daughter to assume her mother's loan and this action by the department violates its current regulations. The department has proposed an amendment to its current regulations to allow the assumptions of MPROP loans in circumstances where there will be periodic payments on the assumed loan, and where the assumption is necessary to prevent a financial loss to the department.

Without adequate monitoring, the department cannot ensure that all borrowers comply with the program requirements and the terms of the notes. It also cannot ensure that long-term loans receivable that have become due and payable because of the borrowers' deaths or noncompliance with the MPROP agreement are identified and collected.

Criteria

The California Code of Regulations, Section 8030, requires the department to monitor the borrowers to protect its security interest in the program loans and to ensure that the borrowers comply with its program requirements.

The California Code of Regulations, Section 8004, states that loans made under the Mobilehome Park Purchase Ownership Program are not to be assumable by another borrower.

Recommendation

The department should monitor individual borrowers monthly or at least quarterly instead of annually to ensure that they comply with its program requirements and that it protects its security interest in the program loans. The department should also promptly follow up on loans that have become due and payable.

The department should comply with its current regulatory requirements, which prohibit the assumption of loans, until the proposed amendment is approved.

View of Department

The department does not generally concur with the recommendation stating that it has currently developed an annual program for monitoring its borrowers' compliance with program requirements and for ensuring that it protects its security interest in program loans. Based upon its first review of the history of the MPROP portfolio for borrowers' activities, only 3.6 percent of the loans were found in noncompliance. The extremely low number of unreported infractions suggests that in a majority of instances, the surviving spouses or heirs notify it of deaths or that concerned borrowers attempt to work out a solution with it for problem loans.

The existing program for annually monitoring occupancy through the records of homeowner associations is the most efficient and cost-effective monitoring mechanism available within the current program financial resources. Should continued annual monitoring uncover a greater percentage of noncompliant loans, the department states that it will reconsider increasing the frequency of its monitoring.

Department of Housing and Community Development

Reference Number: 96-6-3

Condition

The Department of Housing and Community Development (department) needs to improve internal control over the payment of airline and car rental invoices. Specifically, the department does not verify airline and car rental charges with employee travel receipts before it pays invoices, as required by the State Administrative Manual. When travel expenses are not properly verified, the department cannot ensure that it is paying only for actual costs incurred for state service.

For fiscal year 1995-96, the department reported total airline expenditures of approximately \$53,000 and total car rental expenditures of approximately \$22,000. We reviewed approximately \$52,000 of airline expenditures and \$14,600 of car rental expenditures and found the department did not verify the total amount of airline charges and \$13,600 of the car rental charges before it paid the expenses.

We reported a similar finding in our prior years' audits. In response, the department's accounting officer stated that during fiscal year 1995-96, the department revised procedures to compare airline and rental car invoices with approved travel itineraries prior to paying invoices. However, its procedures do not meet the requirements of the State Administrative Manual and do not provide assurance that the department is paying only for actual costs incurred for state service. Moreover, we found the department does not always compare charges to approved travel itineraries. For 7 of the 28 airline charges we reviewed, it could not provide approved travel itineraries to support charges totaling \$974. In another instance, the department paid an airline charge of \$84 before it received an approved travel itinerary.

Criteria

The State Administrative Manual, Section 8422.114, requires that employees submit the passenger copy of an airline ticket with travel expense claims. The departments should then compare the airline invoice to the passenger copy to verify the charges.

The State Administrative Manual, Section 8422.115, requires that employees submit the customer copy of the car rental contract with the travel expense claim. In addition, the department should compare the customer copy with the car rental invoice to determine the propriety of the charges.

Recommendation

To ensure that it pays only for actual travel costs incurred for state service, the department should follow the requirements of the State Administrative Manual for verifying airline and car rental charges prior to paying the invoices.

View of Department

The department agrees with this recommendation. The department will review its existing procedures and either request Department of Finance exemption from the requirements of the State Administrative Manual, Sections 8422.114 and 8422.115, or incorporate the requirements into its procedures during fiscal year 1997-98.

Department of Housing and Community Development

Reference Number: 96-6-4

Condition

The Department of Housing and Community Development (department) continues to lack adequate control over its revolving fund. During our review of fiscal year 1995-96 expenditure transactions, we found that the department improperly used this fund to pay withholding taxes on behalf of one of its employees and to pay a vendor invoice that could have been scheduled for payment through the State Controller's Office (SCO). In addition, the department did not always promptly request reimbursement for its revolving fund. Weaknesses in control over revolving fund disbursements can result in the misuse of state funds.

During our review of fiscal year 1995-96 revolving fund disbursements and unreimbursed disbursements from prior years, we found the department improperly used the revolving fund for two of the eight disbursements we examined. In the first case, the department improperly paid withholding taxes totaling \$5,049 to the SCO in June 1995 on behalf of one of its employees. The department had failed to withhold a sufficient amount of income taxes from relocation expenses paid to the employee during January and February 1995, so it paid the withholding taxes for the employee. Although the department has sought reimbursement from the employee, as of June 30, 1996, approximately \$2,600 of the \$5,049 remains unreimbursed. In September 1996, the department arranged for the employee to repay the balance with a \$100 per month payroll deduction. In the second instance, the department used the revolving fund to pay airline charges totaling approximately \$3,800, that could have been paid using a warrant from the SCO.

While state administrative requirements allow the department to use its revolving fund to pay vendor invoices that require immediate payment, the department made the payment 41 days after it received the invoice.

We also noted that the department does not always promptly request reimbursement for revolving fund disbursements from the SCO. Specifically, in three of the eight instances we reviewed, the department requested reimbursement for employee travel and office expenses 118 to 145 days after it issued checks. As of June 30, 1996, the department had unreimbursed revolving fund disbursements, totaling approximately \$25,000, outstanding for more than 60 days. We reported a similar finding in our fiscal year 1994-95. In response, the department stated that it could not always request the SCO to reimburse revolving fund disbursements promptly because the reimbursements are provided through an account in the State's general fund, for which the department has a limited appropriation. However, the State Administrative Manual, Section 8110, requires that the department should make revolving fund disbursements only when a sufficient appropriation exists for the expenditures.

Criteria

The State Administrative Manual, Section 8110, describes the permissible uses of the revolving fund as payment for earned compensation, traveling expenses, and advances, or where immediate payment is necessary.

Additionally, the State Administrative Manual, Section 8047, requires state agencies to promptly schedule claims for reimbursement of office revolving funds.

Recommendation

To improve controls over its revolving fund, the department should ensure that it uses the revolving fund only for purposes described in the State Administrative Manual. In addition, the department should implement the necessary corrective action to ensure prompt reimbursement to the revolving fund.

View of Department

The department agrees with the recommendations and provides the following comments. During the past year, the department's accounting administrators have written comprehensive procedures and trained staff to improve controls over the revolving fund. In addition, the department has cleared long-outstanding items from the revolving fund and implemented an improved revolving fund reconciliation process. The department will review its procedures for disputed invoices in order to prevent a recurrence of the information found during the audit.

However, according to the department's chief deputy director, the department will continue to experience cash flow problems due to its small general fund appropriation and its multi-funded structure. The department uses the general fund to pay expenditures. Then, monthly, through a plan of financial adjustment, the department uses special funds to reimburse the general fund. In the past year, the department has attempted to alleviate cash flow problems by gaining Department of Finance approval to consolidate four special funds into other existing funds.

Department of Consumer Affairs

Reference Number: 96-6-5

Condition

Neither the Board of Pharmacy (board) nor the Department of Consumer Affairs (department) maintains adequate accounting records supporting advance payments made to the U.S. Postal Service for the board's bulk mail postage. Specifically, we noted that the board made an advance payment of \$8,500 to the U.S. Postal Service for the bulk mail postage of 38,000 newsletters. However, the Postmaster mailed only 36,600 newsletters at a total cost of \$8,254. Thus, the actual cost of the mailing was \$246 less than the board estimated and yet the board did not request reimbursement for this overpayment.

The advance payments made to the U.S. Postal Service are deposited into postal account #685, which the department established for its boards and bureaus. According to the department, each board and bureau is responsible for accounting for its advance payment. However, the U.S. Postal Service does not send the boards and bureaus an invoice detailing the actual number of items mailed and the actual cost of the postage for them. In some cases, the U.S. Postal Service will send a "Statement of Mailing with Permit Imprints" (invoice) to the department; however, the department does not forward the invoice to its boards and bureaus. Furthermore, the department has neither a procedure in place to reconcile advance payments to the actual costs incurred nor a procedure to request reimbursements for overpayments.

When neither the department nor the board reconciles the advance payments made to the account to the actual postage costs, then neither is aware of whether it should request reimbursement for overpayments. Further, since there are no subaccounts, a board or bureau requesting bulk mailings can potentially use funds deposited by another board or bureau, without reimbursement, if its mailing is processed before that of the board or bureau that has made the deposit.

Criteria

The California Government Code, Section 13401, requires agencies to maintain an effective system of internal control. Furthermore, the California Government Code, Section 13403, requires that the system of internal control include, but not be limited to, record-keeping procedures to provide effective accounting control over assets, liabilities, revenues, and expenditures.

Recommendation

The department should establish procedures to account properly for the advance payments made to the U.S. Postal Service. Specifically, the procedures should require the department to identify the following:

- The party responsible for requesting the “Statement of Mailing with Permit Imprints” upon completion of the mailing. This statement provides the name of the board or bureau, mailing date, total number of pieces mailed, and postage cost.
- The party responsible for requesting the reimbursements for overpayments made to the U.S. Postal Service.

Further, the procedures should be communicated to all boards and bureaus.

View of Department

The department agrees with this finding and states that it is developing procedures to track the prepayments for postage issued for each board’s and bureau’s bulk mailings and to reconcile actual costs to these prepayments upon receipt of the invoice from the U.S. Postal Service. The department states that it will be responsible for requesting refunds of unused prepayments and such moneys will be returned to the appropriate department fund.

Department of Consumer Affairs

Reference Number: 96-6-6

Condition

The Department of Consumer Affairs (department) does not track accumulated leave balances and, as a result, cannot determine such balances for approximately 6,104 of the 6,159 examination proctors on record as of March 1997 that are used by its boards and bureaus. To assist in administering exams for licensure, the department’s boards and bureaus use proctors. The proctors are intermittent employees who accrue leave credits after they accumulate 960 hours or 120 days of paid employment. However, the department does not provide the approximately 6,104 proctors with annual statements of leave.

As a result of the department’s failure to track the accumulated leave balances, proctors who have either separated from state service or obtained permanent positions in state service may not receive full compensation or credit for their leave balances. The department anticipates that approximately 82,500 proctor hours will be needed annually to complete licensing examinations. This represents the equivalent of approximately 42 full-time employees. If each of the examination proctors had previously worked over 120 days, they would collectively accumulate credit for over 400 hours of vacation annually. However, the department states that it maintains leave cards for only the 55 proctors whose work history shows regular or continuous work for the department. As an example of the magnitude of the problem, the department did not maintain a leave card for a proctor who worked for approximately 15 boards over a number of years. When the proctor left the department to work full-time for one of the boards, she requested an accounting of her accrued leave credits. The department calculated that she had accrued 576 hours of sick leave and 612 hours of vacation.

The department cites the difficulty in tracking the hours the proctors have worked over the years for the various boards, bureaus, and other state agencies and its limited staff resources as reasons for not maintaining leave cards or providing annual leave statements to its proctors. Further, the

department states that it is currently in the process of implementing a plan to correct the problem. Specifically, the department's plan includes hiring a contractor to provide some of its proctors as well as establishing a central unit to monitor the leave balances of the remaining proctors it chooses to retain.

Criteria

The State Administrative Manual, Section 8534, states that agencies will maintain sick leave and vacation records for *each* employee using STD. Form 642(A) (intermittent employee leave record). In addition, the section requires that agencies provide *each* employee an annual leave statement.

The California Government Code, Section 19839(a), states that a person is entitled to a lump-sum payment, as of the time of separation from state service, for any unused or accumulated vacation or annual leave.

The California Code of Regulations, Title 2, Section 599.740(a), states that intermittent employees shall accrue vacation credits following the completion of 960 hours or 120 days of paid employment.

Recommendation

The department should implement its plan for examination proctor services which includes hiring a contractor to provide some of its proctors as well as establishing a central unit to monitor the leave balances of the remaining proctors it chooses to retain.

View of Department

The department recognizes its responsibility to maintain leave cards for and provide annual leave statements to all of its employees. According to the department, it is in the process of establishing a central appointment unit to track better the total hours which each proctor works and therefore facilitate maintaining leave records. Also, the department is in the process of implementing a plan to contract out some of the proctor services.

Department of Transportation

Reference Number: 96-6-7

Condition

The Department of Transportation's (department) controls over contracts are not sufficient to ensure that total payments do not exceed agreed upon amounts. Specifically, the department approved a vendor's claim for payment that exceeded the balance on the contract by \$146,476. Because the department's accounts payable section did not record an initial payment and the district office contract administrator did not consider previous payments when approving the invoice the vendor submitted for payment, the department attempted to pay an amount in excess of the contract.

State regulations require that agencies keep records to provide effective accounting control over liabilities and expenditures. When records are not properly maintained, the State assumes a risk that it may overpay on its contracts. In this instance, however, the State Controller stopped payment.

Criteria

The California Government Code, sections 13401 and 13403, requires agencies to maintain an effective system of internal accounting and administrative controls that includes record-keeping procedures to provide effective accounting control over assets, liabilities, revenues, and expenditures.

Recommendation

The department's accounting office should ensure that it posts to contract files all payments made and calculates remaining balances in contracts so that it does not overpay any contracts. Each district office should ensure that its contract administrators do not approve invoices for payment when the dollar amount of the contract is exceeded.

View of Department

The director of the department's Accounting Service Center and the chief of the department's Office of Accounts Payable concur with this finding. The procedures outlined in the recommendation existed in the payment process when the incident occurred. The chief of the Office of Accounts Payable will advise staff of the finding and its potential impact to the State and remind staff of the importance of adhering to procedures.

Since consolidation of the accounting function, contract managers are able to view payment history records within the department's accounting system to confirm the accuracy of their payment records. The chief of the Office of Accounts Payable will remind all contract managers that this capability is available to them to assist in carrying out their responsibility to monitor contract expenditures.